

# ECONOMIC POLICY IN A NEW ENVIRONMENT: FIVE PRINCIPLES



**Research and Policy Committee  
Committee for Economic Development**

The September 11 terrorist attacks on our nation produced horrendous loss of life and extraordinary grief and pain. Provision for the safety and security of our people and nation has now become paramount, and this has created a new policy environment in the United States and across the world. However, we must not let these security concerns eclipse the need for sound economic policies, both domestic and international. In the long term, the health of our economy will largely



determine the well being of our society, including our capacity to provide safety and security.

In 1942, as the country mobilized for World War II at another time of national crisis, the Committee for Economic Development (CED) was formed to strengthen the relationship between business and government in the war effort and to develop principles for postwar recovery.<sup>1</sup> In this same spirit, we offer the principles outlined below as a broad framework for economic policy.



## FIVE BROAD PRINCIPLES FOR POLICY

**1. Develop Short-Term Policies Within A Sound Long-Term Framework.** We are now entering a period of great economic uncertainty that may require significant short-term fiscal stimulus. We still face long-term economic problems, however, which are different in nature and which require very different solutions. We must implement short-term policies without compromising the nation's long-term economic strength. Otherwise, both short and long-term objectives may be undermined, as discussed below.

**2. Define Priorities Sharply.** Larger national security requirements will constrain the economic and fiscal resources available for other purposes. We must resist the facile notion that budget constraints are no longer operative and "anything goes" because we are in a new policy environment. Quite the opposite is true; reconciling large

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1. Karl Schriftgiesser, *Business and Public Policy* (Englewood Cliffs, NJ: Prentice Hall, Inc.), 1963, p. 1.

immediate public needs with private consumption and investment will require more stringent discipline. This is no time to indulge special-interest or government-agency wish lists or partisan policy agendas. Instead, we must take advantage of this crisis-induced opportunity for bipartisanship to carefully define the nation's priorities, both military and domestic.

**3. Do Not Abandon Critical Domestic and International Goals.** The necessarily increased attention to our security goals must not lead us to abandon other critical long-term objectives. First, the lines between security and non-security sectors and issues have become less distinct. Transportation, communications, energy, financial services, private and public health, education and training, and international trade and economic assistance (to name only a few areas) will present new challenges involving our long-term security. Structural changes will be needed, for example, to increase our transportation options and reduce our vulnerability to oil shortages. Second, how we deal with these “non-security” objectives will define the kind of society we have in the future. To take but one example, we believe it would be tragic if welfare reform were to fail because we provided inadequate resources to vulnerable families as the labor market weakens, state revenues drop, and time limits constrain program eligibility.<sup>2</sup>

**4. Be Flexible.** There is currently enormous *uncertainty* with respect to the security threat, our future security requirements, and likely changes in the economy. It is therefore essential that policies be

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2. The importance of maintaining and increasing federal and state support for welfare-to-work is discussed in CED's *Welfare Reform and Beyond: Making Work Work* (2000), Chapter 3.

flexible so that they can be modified as necessary when conditions change. The federal government should be prepared to protect and enhance our critical economic and public safety infrastructure, even if this requires unusual and interventionist actions by peacetime standards. We believe the assistance provided to the airlines is justified on these grounds.<sup>3</sup> In addition, this temporary assistance will help preserve competition in the industry by averting consolidation under distressed conditions.

## **5. Rely on A Strengthened Safety Net, Not Industry**

**Subsidies.** We recognize that the immediate shock of economic disruption has affected many individuals, firms, and industries and that a weaker economy will produce hardship in the next few months. As noted, we support direct emergency assistance to industries and firms where the survival of our infrastructure networks is at stake. But we should not provide such subsidies more generally—a policy that would immediately raise impossible questions of equal treatment and quickly undermine the efficiency of our market economy. Instead, existing safety net programs, such as unemployment compensation, should be extended and strengthened to address the risk of greatly increased economic hardship in coming months.<sup>4</sup>

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3. However, we also urge that the provisions in the legislation that would allow U.S. taxpayers to share in future airline profits be vigorously pursued. The legislation authorizes a new Air Transportation Stabilization Board to enter into contracts providing that the government participate in future financial gains of participating companies through warrants, stock options, or other equity instruments. This policy was followed when government assistance was provided to Chrysler in 1980.

4. For CED's recommendations for broadening unemployment compensation, see *American Workers and Economic Change* (1996), pp. 51-53.

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# FISCAL POLICY IN RECESSION AND BEYOND

## Stabilizing the Economy in the Short-Term

The physical destruction in New York and at the Pentagon and the resulting economic disruption of transportation, travel, and other sectors will not cause significant lasting damage to our economy, which is remarkably resilient. But the impact of these unprecedented events on consumer and business confidence and expectations is extremely uncertain and could produce a large temporary decline in consumption and investment expenditures.

Monetary policy has been, and will remain, our principal and most flexible tool for stabilization policy. However, if the decline promises to be large or prolonged, fiscal stimulus may also be required. It is therefore only prudent that we prepare to implement appropriate fiscal measures to increase demand if they prove necessary.

However, if additional fiscal stimulus is required to moderate a recession, it will present a dilemma requiring careful and adroit policy management:

- **On the one hand, the size of the fiscal year 2002 budget surplus or deficit should not be a major determinant of needed actions.** The surplus will be sharply reduced by the large, but temporary, decline in revenues resulting from a recession. Such a drop in the surplus during recession is desirable, reflecting our “automatic stabilizers” at work. The additional emergency spending already planned, plus any additional stimu-

lus measures, will further reduce the surplus, or push the budget into deficit. These budget changes will support a weak economy.

- **On the other hand, any fiscal stimulus must be temporary and combined with a credible commitment to future budget surpluses.** If the decline in the 2002 budget surplus is seen as a prelude to future budget deficits, long-term interest rates will rise, undermining the effects of fiscal stimulus.

In addition to being temporary, any additional fiscal stimulus must be timely and effectively targeted:

- Timely stimulus requires measures that can be implemented quickly, such as a temporary reduction in payroll taxes, further tax rebates, or reductions in allowable depreciation lives, to reflect the rapid economic obsolescence of some equipment.
- Effectively targeted stimulus requires measures that are likely to raise public or private expenditures quickly, such as emergency expenditures under current programs or tax reductions or income support for low- and middle-income individuals.

## **Ensuring Growth in the Longer Term**

Long-term growth provides the economic resources for both our security and our living standards. The aging of our population and the massive retirement of baby-boomers that will begin in 2008 will place additional pressure on these resources. None of this has changed since September 11. But our larger security needs, of uncertain size, will create even greater competition for resources when the economy recovers and returns to high employment. Unless longer-term fiscal policy is

managed carefully, that competition could bring an acceleration of inflation, higher long-term interest rates, and slower economic growth.

Some history is instructive. In the mid-1960s we failed to resolve the conflict between escalating military expenditures for the Vietnam War and domestic expenditures, both public and private. Total national spending exceeded our productive capacity, but we did not offset the increased military spending with either sufficient cuts in other public expenditures or tax increases to reduce private spending. As a result, inflation accelerated, initiating a traumatic 15-year struggle to restore price stability, as oil price shocks in the 1970s exacerbated the inflation.

We must not repeat this mistake. But avoiding inflation is not the only issue. To meet our long-term objectives, we must maintain the higher economic growth that began in the mid-1990s, which resulted in large part from investments in new information technology. Those investments, however, were catalyzed by pro-investment economic policies—higher national saving from growing budget surpluses and the lower interest rates that those surpluses made possible.

Strong economic growth will continue to require adequate national saving and investment in spite of higher security expenditures. Because of our chronically low private saving, adequate national saving will inevitably require significant budget surpluses. *Our long-term fiscal target therefore should be budget surpluses adequate to produce the national saving required for vigorous growth—not merely balance in some measure of the budget deficit.* These future surpluses were already in jeopardy before September 11. Fortunately, the structure of the recently enacted tax cut allows us some policy flexi-

bility, since many of its important changes will become effective only in the future and can be reconsidered.

In this new policy environment, as our national security needs become clearer, we will inevitably undertake a thorough reexamination of our long-term fiscal policy. As we do so, we should examine carefully not only our budget priorities and the effectiveness of many expenditure programs, but also our revenue policies as they affect national saving, investment, and growth. Policies supporting long-term growth will provide the strongest foundation for an economy large and vital enough to provide both higher living standards and the capacity to enhance security and stability, both at home and abroad.

The Committee for Economic Development (CED) is an independent, nonpartisan organization of over 200 business leaders and educators. CED is dedicated to policy research on major economic and social issues and implementation of its recommendations by the public and private sectors.

CED was founded in 1942 to strengthen the relationship between business and government in the transition from war to peace. *Economic Policy in a New Environment: Five Principles* grows out of this tradition and draws on CED's long history of developing economic policies that promote sound, long-term economic growth and stability. It is designed to provide guidance to policy makers and citizens as they make critical economic and national security decisions in new and rapidly changing circumstances.

This report has been endorsed by a majority of the members of CED's Research and Policy Committee.

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